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## DEPARTMENT OF STATE

Washington, D.C. 20520

Executive Registry

82-5480/6

July 23, 1982

SECRETMEMORANDUM FOR MR. DAVID PICKFORD  
DEPARTMENT OF THE TREASURY

SUBJECT: Work in Support of the SIG on U.S.-EC Relations

Attached are State's contributions in response to the SIG-IEP tasking memorandum of July 22. These papers cover points 1, 2, 3, and 4 of Judge Clark's memorandum of July 21.

*L. Paul Bremer, III*  
L. Paul Bremer, III  
Executive Secretary

Attachment:  
Study Papers on Questions 1-4

cc:	OVP	- Mrs. Nancy Bearg Dyke
	NSC	- Mr. Michael O. Wheeler
	Agriculture	- Mr. Raymond Lett
	CEA	- Mr. William Niskanen
	CIA	- [Redacted]
	Commerce	- Mrs. Helen Robbins
	Defense	- COL John Stanford
	OMB	- Mr. William Schneider
	USTR	- Mr. Dennis Whitfield

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Washington, D.C. 20520

OBJECTIVES OF U.S. ECONOMIC POLICY TOWARD EUROPE

I. General US Goals

- A. Protect most important US economic interests
- B. Prevent economic and trade disputes from undermining transatlantic cooperation on fundamental political and security issues.
- C. Pursue dialogue with the Europeans to contain economic problems and reduce tensions, after we have set our own priorities and identified areas for possible shifts in policy by the US and Europe.

II. Specific Issues

A. Macroeconomic Policy

- 1. Convince Europeans that we are following a coherent strategy for controlling inflation and lowering budget deficits and interest rates.
- 2. Demonstrate that we are prepared to follow up on Versailles commitments on macroeconomic co-ordination and study of exchange market intervention.
- 3. Use action on 1 & 2 above to reduce Europeans' tendency to use the US as a scapegoat for their failure to deal more effectively with their own economic problems.

B. East-West

1. Sanctions

- a. Maintain pressure on Soviet Union and Poland.
- b. In view of European decision to challenge pipeline sanctions, examine our legal options so as to preserve our credibility, while minimizing damage to our future trade in high technology.
- c. Seek coordination on responses to July 22 announcements in Poland to prevent precipitate European action.

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2. Credits

- a. Increase pressure on Soviet Union through coordinated allied action.
- b. Follow up on recent agreement on the OECD Consensus Agreement to raise the cost of official credits to the USSR.
- c. Concentrate now on improving data collection and policy-oriented discussion in the OECD and NATO.
- d. Move later, using that information, and, after the current crisis cools, toward setting up a Summit Monitoring Group and, eventually, more restraints on lending.

3. Polish Debt

- a. Preserve our leverage by not triggering a generalized default.
- b. Coordinate decisions with Allies as to whether July 22 announcement merits rescheduling.
- c. Avoid isolation from Europeans so that we do not lose leverage.

4. Long-Term Grain Agreement with the USSR

- a. Preserve markets for our farmers and ensure decision on the Agreement that is consistent with other aspects of US policy.
- b. Resist European efforts to use US grain sales as justification for go-ahead on pipeline and/or other actions.

C. Trade

1. Steel

- a. Protect US industry from unfair trade practices.
- b. Demonstrate that GATT Subsidy Code can work to increase market discipline.
- c. Seek global settlement as preferred option, before August 24.

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## 2. Agriculture

- a. Encourage improved discipline on EC export subsidies.
- b. Negotiate stronger GATT rules on agricultural trade.
- c. Deflect EC efforts to force renegotiation of tariff bindings (corn gluten-soybean).
- d. Engage EC in dialogue on problems of agricultural trade. This would involve a lowering of rhetoric and reexamination of policies on both sides (EC on subsidies--US on weaker GATT cases which have not yet gone to panel).

## 3. GATT Ministerial

- a. Obtain EC cooperation in pushing a broad agenda for strengthening the international trading system. Our priorities include initiatives on agriculture, services and trade-related investment, high technology and a North/South round of trade negotiations. [Many Europeans are lukewarm, at best, about the scope of our proposals and, on some, actively opposed (agriculture)].
- b. Consider whether sharpened emphasis on areas to which EC is now receptive (services, North/South round) can improve cooperation.

## D. Energy

1. Accelerate efforts to develop credible energy security program, through US domestic measures and efforts in Europe. (Under Secretary Buckley chairs an Alternatives Energy Group, which plans to present a package to the President soon.)
2. Continue to discourage undue European vulnerability to cutoffs of Soviet natural gas.

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*mj*  
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Washington, D.C. 20520

ASSESSMENT OF CURRENT US-EUROPEAN  
ECONOMIC RELATIONS AND THEIR IMPLICATIONS

SUMMARY

As a result of grievances on both sides, US-European relations have entered a tense and difficult period. Current frictions may have repercussions in the economic, political and security fields. These frictions, reflected in the heightened rhetoric emanating from Europe, reflect long-standing differences in approach to economic, political and Third World relations. Two immediate issues of concern to the EC, however, are the recent U.S. decision to extend sanctions against Poland and Commerce's determinations on steel subsidies.

At the same time, we have legitimate grievances against the EC in the fields of agriculture, macro-economics and East-West financial relations.

Unless current tensions are alleviated, our assessment is that the Allies could become less willing to cooperate with us on questions of priority U.S. interest, e.g., improvements in the international trading system and sustained, non-inflationary economic growth. If not reversed, this could ultimately impact on various political/security initiatives and undermine much of the spirit of confidence on which effective Alliance relations depend.

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## DEPARTMENT OF STATE

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ASSESSMENT OF CURRENT US-EUROPEAN  
ECONOMIC RELATIONS AND THEIR IMPLICATIONS

US-European relations have entered a tense and difficult period as a result of grievances on both sides. These grievances stem from differing assessments of geo-political and economic interests, as well as from divergent historical and governmental traditions. Foreign Minister Cheysson recently stated that France and the US "no longer speak the same language," while other respected European leaders, including FRG Chancellor Schmidt, contend that the US seems totally indifferent to European problems. This rhetorical outburst reflects frustration due, in part, to long-standing differences in approach to political, economic and Third World relations.

Two main issues of immediate concern to the EC are: (1) the US decision to extend extraterritorially and retroactively the sanctions on oil and gas equipment and technology; and (2) Commerce's preliminary determinations on European steel subsidies.

The long-simmering pipeline issue has now moved to the forefront. Over a year ago, at the Ottawa Summit, the US objected to purchases of Soviet gas by Western Europe. European leaders, in signalling their intention to proceed with the pipeline arrangements, have argued that economic sanctions are ineffective and that Soviet orders for pipe, compressors and other equipment will benefit European firms. The EC now contends that the extension of the US embargo to licensees of US firms in Europe is illegal, and the French Government has authorized Alsthom-Atlantique to produce the necessary rotors.

Continuing failure to resolve the US-EC steel dispute will heighten tensions in the trade field. The EC has already begun to consider retaliatory steps.

US complaints against the EC are equally important, however. For example, we have legitimate grievances in the agricultural trade field, to which the Community pays little heed. The EC, through its production support policies, disrupts trading patterns and challenges market shares of traditional exporters, including the US. Equally nettlesome is the European tendency to adopt a "business as usual" approach to the USSR, even when normal commercial prudence would dictate otherwise. In the context of Soviet adventurism in Afghanistan and elsewhere, granting preferential terms to the USSR is

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inappropriate. Finally, unwillingness in some European countries to undertake domestic economic reforms (by curbing social welfare and other expenditures) is disturbing to us, since these same countries are prone to criticize U.S. budgetary and other policies.

US-European frictions over economic matters, including US sanctions on oil and gas equipment, are serious in their own right. But, they assume special significance in light of persistent economic stagnation on both sides of the Atlantic. The vehemence of European reaction to US actions can only be understood in the context of an unemployment rate of 10 percent (the highest level since the early 1950's) and several years of sluggish economic demand (which is expected to improve by only one percent in 1982). European leaders, worried about the potential political repercussions of this situation, have looked to the US for assistance in their recovery.

However, US economic conditions are also difficult. Real GNP fell by over two percent in 1981. Unemployment has reached postwar peaks. Despite low industrial capacity utilization, the US continues to be plagued by high real interest rates -- hampering recovery both here and abroad. Significant progress has been made in curbing inflation, however, the foremost priority in US macroeconomic policy.

The lines in the economic and trade field are thus clearly drawn: the situation has significant implications for US interests and objectives in the economic, political and security fields.

Economic

In the trade field, we had a trade surplus of over \$10 billion with the EC in 1981. Our exports consisted of \$42 billion of industrial goods and \$9 billion of agricultural commodities. The US is most vulnerable to EC action in the agricultural area, particularly to a possible tariff quota on corn gluten exports and/or a tax on vegetable fats and oils which would affect our large exports of soybeans.

The US is also vulnerable to EC actions on two additional fronts: the DISC and US price controls on natural gas. In both areas, the EC has laid the groundwork for quick action. The necessary studies have been done and GATT consultations have already taken place.

The US-EC trade conflicts are now sufficiently serious that they will, if not alleviated, affect our ability to work with the EC in the GATT Ministerial in November. We have an

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ambitious agenda for the meeting, and have attached a great deal of importance to having it launch a GATT work program on international trade in services, trade-related investment rules, and trade in high technology goods. If the Ministerial takes place without significant progress on those items, it could undercut the role of GATT and thereby the multilateral trading system which redounds to US advantage.

The growing rift in US-European relations could make it more difficult to proceed with the consensus on macro-economic policy reflected at the Versailles Summit and OECD Ministerial, particularly regarding the priority accorded to curbing inflation to ensure durable economic recovery. Although domestic determinants will remain most important for all European leaders, some may be more inclined to despair of US understanding of their domestic problems and proceed more on their own stimulative economic courses for greater job creation which, in turn, could undercut the longer-term interests of the OECD membership as a whole.

Political

Failure to address promptly the confluence of contentious economic issues in US-EC relations could result in a further deterioration of US-EC economic relations and ultimately jeopardize our political relationship with our Allies. It could play into Soviet hands by sharpening divisions in the Alliance.

Europeans perceive recent US decisions on steel, expansion of Polish sanctions, and Law of the Sea as indications of a new US determination to pursue our own interests, without regard for the interests of traditional friends and Allies. This perception could strengthen the hands of European advocates of a distinctly European approach to political/security issues, e.g., the Genscher-Colombo plan. Political disunity in the transatlantic community would jeopardize our cooperation with the Allies on East-West relations, the Middle East, Southwest Asia, the Caribbean, Africa and Southeast Asia. It would also jeopardize our pursuing common objectives on other important issues, e.g., Law of the Sea and nuclear non-proliferation - especially where European commercial interests and relations with the Third World are concerned. The United States cannot hope to realize its objectives in these areas without the cooperation and support of our Allies.

Security

Current tensions in US-European relations could also spill over into the security area. Our efforts to build a strong

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Alliance consensus on policies necessary to bring about Soviet restraint and responsibility could be damaged by Allied anger over economic issues, coupled with the perception that we are seeking to impose an "economic warfare" strategy on our Allies. More specifically, the Allies could be less willing to make political or economic sacrifices to carry out key security initiatives or to cooperate on questions of priority US interest if they believe we are insensitive to their own needs and concerns. Fundamental security interests remain unchanged, and the current strains do not yet threaten the Alliance. They do, however, weaken the spirit of mutual confidence on which effective Alliance consultations and action depend. These tensions may damage the NATO consultative process by encouraging the tendency of EC partners to consult, and even reach decisions among themselves on issues of direct concern to us and the Alliance as a whole.

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P: TPuio

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## Future Decision Points

### SUMMARY

The key decision points coming up between now and October on US/EC economic issues are as follows:

-- On steel, a preliminary determination in one additional subsidy case is due August 2, those in the first group of dumping cases are due August 9, and a final determination on countervailing duties in the first group of subsidy cases is due August 24. This is the last date on which petitions could be withdrawn in conjunction with a negotiated settlement of these cases. If we have not reached a settlement by August 24, an injury review would follow.

-- On agriculture, a number of meetings will take place in mid-September under GATT auspices covering corn gluten, wheat flour, sugar and U.S. agricultural programs (Section 22). Unless we have started an improved agricultural dialogue by then, these sessions are likely to be stormy. At about the same time, the GATT Director General is likely to be pursuing a conciliation effort on citrus, and the GATT will consider an EC complaint against the DISC.

-- On East-West issues, extended sanctions take final effect August 14, and European companies must ship certain covered items or face contract penalties by September/October.

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### July

Grains: U.S. decision is due shortly on long-term grains agreement with the USSR. Any decision involving larger amounts is likely to add significantly to the frictions in US/EC economic relations.

### August

Steel: There are a number of individual cases involving dumping or subsidization of steel from the EC, and each has its own set of deadlines. The key decision points in August are:

- |          |  |
|----------|--|
| August 2 | Commerce preliminary determination of subsidy due in cases against welded pipe from France, FRG  |
| August 9 | Commerce preliminary finding due in dumping cases on "certain steel products." A positive finding will complicate the task of negotiating a settlement based on withdrawal of cases. |

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August 24

Commerce final subsidy finding due in countervailing duty cases on "certain steel products." This is the last date on which petitions could be withdrawn in conjunction with a negotiated settlement of these cases.

The cases against PC strand, wire rod, welded pipe, and stainless steel sheet and strip were filed later, and final determinations for these are therefore due between October 25 and next February.

Citrus: In view of the GATT Council's inability to decide on the formation of a panel to adjudicate our dispute with the EC over their citrus preferences, GATT Director General Dunkel has been asked to use his good offices in a conciliation attempt on this politically sensitive dispute. His efforts may take place in August and/or September.

September

Pipeline:

August 14      Extended sanctions formally take effect.

Agriculture: A number of US/EC agricultural disputes will come up for formal discussion in GATT or bilaterally, or for internal decisions. Each of the GATT consultations and meetings outlined below could be stormy and make it more difficult for us to find a peaceful exit from our disputes over agricultural trade, unless we have been able to engage the EC in a more constructive dialogue on agricultural issues between now and mid-September.

September 20      Working Party on the U.S. GATT waiver for agricultural programs (Section 22 waiver); EC could use meeting to complain about our attacks on their agricultural system.

September 21      GATT Article 22 consultations with the EC on corn gluten, on which EC has been interested in withdrawing a tariff concession of major importance to U.S. trade.

September  
23-24

(tentative) GATT Article 22 consultations with the EC on sugar.

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(Date uncertain)

GATT panel report expected in  
US/EC dispute on wheat flour

September 30

Deadline for interagency status  
report to the President on GATT  
complaint involving EC and possibly  
Brazilian subsidies on poultry  
exports.

In addition, we may continue our negotiations with  
the EC on tariff adjustments following Greek accession to  
the EC some time in September or early October. The key  
commodities at issue are agricultural, but the main point  
of contention is the EC's argument that it is owed a "credit"  
for the liberalization of the Greek trade regime, a view for  
which we believe there is no basis in GATT precedents.

In mid-September, the GATT Council will review the DISC  
program. In discussions thus far, there has been no support  
for the U.S. position that the DISC is a tax deferral and  
therefore not a subsidy.

East-West:

September-  
October

European companies may ship pipeline-  
related equipment covered by U.S.  
sanctions or face penalty clauses in  
their contracts with Soviets

September 30

Expiration of current US/USSR grain  
agreement

October

October 30

Deadline for interagency status report  
to the President on Section 301 com-  
plaints about EC sugar policies

Decision points

Drafted: EB/TDC/OT - TCSchaffer

Clearance: EB/TDC - DLamb  
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General US Approach to Transatlantic Economic Issues

In managing current issues with its European Allies, the SIG could consider the following procedural options for responding to European concerns:

1. A visible, high-level response beginning a "new dialogue."

This option could involve a variety of new steps, such as sending a Cabinet-level delegation to Europe or inviting the EC Council President to visit President Reagan, to demonstrate special sensitivity to European concerns and reinforce existing consultations and negotiations. It involves no high-level negotiations on specific issues.

2. Address key issues through existing channels with greater intensity and commitment.

This option precludes any special steps outside existing channels and ongoing negotiations but implies a commitment to pursue existing issues with greater vigor and willingness to achieve compromises based on mutual concessions.

3. Some combination of one and two above.

This option involves special steps, perhaps including the designation of a Cabinet-level official, or officials, to carry on intensified negotiations with the Europeans designed to demonstrate and reinforce enhanced commitments to pursue solutions to issues in existing channels.

4. Pursue business-as-usual in US-European economic relations.

This option involves focusing on already scheduled events and negotiations in US-EC relations and pursuing these activities in line with recent levels of emphasis (i.e., pre-summit and since). No special high-level activities.

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As far as our general approach to these discussions is concerned, individual issues are dealt with in specific options papers, but a few generalizations may be useful:

1. US policy should stress continuity, consistency, a low-key, action-oriented approach, and, above all, not raise expectations that cannot be fulfilled. Rather than being defensive or apologetic, we should approach the Europeans with a sincere desire to pick up their appeal for a dialogue, pointing out that this cannot focus on US policies alone.

2. The nature of our differences with the EC does not lend itself to "trading off" across issues. However, the timing of our decisions may affect the tenor of our dialogue, and, where possible, we should take this into account. Poor timing can give the appearance of a coherent anti-European policy where none exists.

3. We can address our problems in other areas more productively if we dissociate them from our differences on East-West economic relations.

4. Substantively, the area in which we are most in need of creative new approaches to our problems is trade. If we opt for either procedural option 1 or 2, we should stress an effort to find new ways to deal with our problems, especially on agricultural issues.

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General US Approach to Transatlantic Economic Issues

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